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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
Price Cap Performance Review for Local Exchange Carriers	)	**CC Docket No. 94-1**

TO THE COMMISSION

COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY

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SUMMARY*

As everyone knows by now, a homemade sign reading "The economy, stupid!" was placed prominently on the wall of then Presidential candidate Clinton's campaign headquarters to remind everyone to stay focused on the most important theme.** Just as this sign was used to focus the Democratic Presidential campaign in 1992, it should be used to direct the Commission in the LEC price cap performance review. Modifications that increase economic benefits are required.

Since the genesis of LEC price cap regulation, the telecommunications industry has changed dramatically. Many more competitors for local exchange and access services have arisen, most significantly through the proliferation of CAPs. These competitors are not subject to the same constraining regulation as LECs. The explosion of technology and increased competition has enlarged the impact of telecommunications on the economy.

In light of these changes, it is time to reassess how positive telecommunications public policy can assist the economy. The current method of LEC price cap regulation limits the benefits to the economy from the telecommunications industry. If SWBT and other LECs were allowed to operate under the changes suggested here, those benefits would be profound. If, on the other hand, no changes or ill-advised changes to the LEC price cap plan are made, not only will the economy fail to reap all the benefits possible from the telecommunications industry, but the current benefits will decrease.

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* All abbreviations used herein are referenced within the text.

** Joseph W. Duncan, "The economy, stupid!" D&B Reports, January/February, 1993, p. 6.

In this proceeding, evidence will show that LEC customers have benefitted from the initial steps toward more flexible regulatory oversight embodied in the current price cap plan. These benefits have been manifested in various ways: the Consumer Productivity Dividend (CPD) has lowered prices overall, LECs have voluntarily priced under the caps or used a higher productivity offset, new services have been introduced, and the level of universal service has risen. LEC earnings have been within the range that the Commission identified as acceptable, especially when compared with AT&T's earnings performance. Service quality has remained high.

Notwithstanding these benefits to consumers, there is ample evidence to show that changes to the LEC price cap plan must be made to further benefit the economy. The CPD should not be increased and sharing should be eliminated. The formula for sharing common line revenues must be changed. The existing definition for exogenous costs and their treatment under current price cap rules should not be changed. The LEC price cap price plan should be altered to provide regulatory symmetry with LEC competitors. Most importantly, the next iteration of price cap regulation must, when viewed in its totality, provide the incentives that are needed by the LECs to make the kind of investments in telecommunications infrastructure that are envisioned by public policymakers.

To make these changes, SWBT fully supports the USTA proposal for price cap reform, which should be incorporated into the Commission's access charge rules by the end of 1994. Service baskets should be restructured into groups of similar access functionalities. Rate elements other than those classified as public policy elements should no longer be codified. Support and notice requirements should be directly related to the existence of competition. New

services should be further encouraged. Adoption of these proposals will create a truly competitive marketplace.

As the comments are filed in this proceeding, a debate between two factions will likely occur. One faction, LEC competitors, will be interested in seeing more restrictive regulations on LECs, while the LECs will advocate less restrictive regulations. The outcome of this debate will significantly alter the path of the nation's telecommunications infrastructure.

By its actions, the Commission can significantly improve the competitive position of the U.S. economy. If the Commission does not take forward-looking actions to encourage private investment in the telecommunications infrastructure, the U.S. economy will suffer permanent losses. Halfway measures will not be enough. Experience with the current price cap plan and the status of markets clearly indicates that the Commission should put an adaptive market-focused regulatory paradigm in place now. Achievement of our common goals requires nothing less.

The LEC price cap plan in place today is not acceptable to investors and LEC management. Without the investment support provided by the price cap LECs, the Commission's goals for the telecommunications infrastructure and the economy will not be achieved. The financial discipline of efficient capital markets will guarantee that result. SWBT respectfully requests that the Commission expediently adopt the changes described herein and allow consumers and the economy to reap the maximum benefit from the telecommunications marketplace.

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COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY

Southwestern Bell Telephone Company (SWBT), pursuant to the Notice of Proposed Rulemaking released February 16, 1994,[1] hereby files its comments in this proceeding. SWBT's proposals will facilitate economic growth and national productivity and will significantly improve the current Local Exchange Carrier (LEC) Price Cap Plan.

I. INTRODUCTION (General Issue 1)

The NPRM states that the telecommunications industry has witnessed dramatic changes in technology and markets within the last few years. Additionally, the Federal Communications Commission (Commission) noted that the potential contribution of telecommunications to our society and economy has never been greater.[2] These statements reflect a commonly held view by industry experts and are consistent with the Clinton Administration's position on the development and implementation of an information superhighway. It is becoming increasingly apparent that telecommunications is an integral part

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[1] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Notice of Proposed Rulemaking (FCC 94-10), released February 16, 1994 (NPRM).

[2] NPRM, para. 3.

of business and is vital to the health of other industries. As telecommunications has become more important, and as technology has changed, regulatory policy must also change.[3]

A. The Impact Of Telecommunications On Other Industries Is Substantial.

The President's Progress Report recognizes the importance of new technology to conventional industries because technology improvements lead the way to market-building improvements in existing products and services, manufacturing processes, and overall business performance.[4] The Report states that new technology is the foundation of productivity increases, job creation, and gains in wages. Advances in technology account for as much as three-fourths of U.S. productivity growth during the last century. On a global scale, the Report indicates that high technology products account for a rapidly increasing share of world manufacturing output, nearly doubling to about 35 percent since 1980.[5]

Many of those who are concerned about the U.S. economy look to the communications/information sector to provide the impetus for future growth.[6] The impact on American businesses will not be limited only to those who are in the information business.

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[3] A recently completed paper by Strategic Policy Research, Inc. (SPR) describes the appropriate vision for these changes. Strategic Policy Research, Inc. "Regulatory Reform for the Information Age: Providing the Vision," January 11, 1994, pp. 17-21. A copy of this paper is attached as Appendix SPR.

[4] Technology for Economic Growth: President's Progress Report (October 28, 1993), p. 10.

[5] Id., p. 10.

[6] U.S. Congress, Office of Technology Assessment, Critical Connections: Communication for the Future, OTA-CIT-407 (Washington, DC: U.S. Government Printing Office, Jan. 1990), pp. 5, 107.

Virtually every business will find it possible to use these new tools to become more competitive.[7] As more firms increasingly value telecommunications services, and as more firms find new ways to implement telecommunications services, demand will increase. Additionally, firms will exercise their entrepreneurial talents by incorporating such services into their overall business strategy. There is a clear pattern of evidence that identifiable and quantifiable gains by business and industry can be attributed to improved telecommunications.

Industries using telecommunications more intensively tend to have higher employment growth. A 1993 Data Resources, Inc. (DRI) study[8] concluded that the Arkansas economy would have lost an additional 2300 jobs during the 1980-82 recession had telecommunications not advanced from 1977 technology. The telecommunications intensity[9] of finance, wholesale, and business services is about 3 to 4 percent, and their employment grew at annual rates from 1.7 to 7.1 percent each year from 1981 to 1988, while three of the industries which use telecommunications least intensively (e.g., agriculture, mining, and other manufacturing) either reported employment losses or no growth in the same period.[10] The

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[7] Remarks Prepared for Delivery by Vice President Al Gore, Royce Hall, UCLA (January 11, 1994).

[8] Francis J. Cronin, "Telecommunications Network Modernization and the Arkansas Economy," DRI/McGraw-Hill study prepared for SWBT (August 1993), p. 32 (DRI Arkansas Study). Attached here as Appendix DRI ARK.

[9] Telecommunications intensity is the ratio of an industry's telecommunications spending to its total output.

[10] U.S. Department of Commerce, National Telecommunications and Information Administration, Notice of Inquiry, Comprehensive Study of the Domestic Telecommunications, Infrastructure, study prepared by National Economic Research Associates, Inc., "Telecommunications Infrastructure, Productivity, and Economic Development" filed by USTA, April 9, 1990, Appendix 1, pp. ii, 15.

telecommunications intensity of the U.S. economy increased at a rate of 3.9 percent per year over the 1965-1987 interval.[11]

Telecommunications innovations are occurring in all sectors of the economy. Estimates indicate that telecommunications expenditures constitute approximately 10 percent of the Fortune 1000 companies' budgets in 1993.[12] Over a decade ago, U.S. revenues that came directly from the communications, computer, information, and knowledge industries already totaled three times those from the steel industry, twice those of the automobile industry, and were equal to the oil industry.

Telecommunications-intensive industries employ a much larger share of workers than other U.S. industries. The four most telecommunications-intensive industry segments are financial services, transportation and public utilities, business services and wholesale trade. Total employment represented in these industries is nearly half of the U.S. employment and is growing more rapidly than the overall U.S. average. In some cities, these industries play an even greater role, representing about 61 percent of the jobs in San Francisco, for example. On the international level, trade in services, especially financial, is accelerating, making major cities nodes in the global information network. Consequently, the importance of international telecommunications is increasing significantly.[13]

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[11] DRI Arkansas Study, p. 3.

[12] Candee Wilde, "Analysts See Happy New Year: Budgets Up," Communications Week, Jan. 2, 1989, p. 29.

[13] Robert H. Wilson & Paul E. Teske, "Telecommunications and Economic Development: The State and Local Role," 4 Econ. Dev. Q. pp. 158, 160, 163 (May 1990).

B. Investment In Telecommunications Is Vital To The Economy.

The extent to which advanced telecommunications capabilities will be incorporated into all segments of society will be governed by the pace of telecommunications infrastructure investment by LECs, Interexchange Carriers (IXCs), Competitive Access Providers (CAPs), other common carriers and private network providers. Both private and public investment are major factors in job creation and economic growth. There is general agreement that the economic effects of infrastructure investment (i.e., productivity improvements, job creation, tax revenue generation) are clearly favorable and profound. The effects of telecommunications infrastructure investment are manifested in long-term significant economic gains over virtually all sectors of the economy. Research performed by DRI indicates that the U.S. economy requires about five years to incorporate up to 50 percent of the benefits from telecommunications infrastructure investment and seven to nine years to realize 90 percent of the benefits.[14] Therefore, any evaluation of the economic impact of public or private infrastructure investment must consider the profound effects that occur over the long term.

C. Regulatory Policy Changes Impact Job Creation

Regulatory policy changes alone can foster job creation and general economic recovery without increases in federal or state budgets. In the federal jurisdiction, for example,

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[14] DRI Arkansas Study, p. 16. DRI also estimates that the consumer price index (CPI) measure of prices in the U.S. economy would have been five percentage points higher in 1982 had the state of telecommunications technology been frozen at 1963 levels for the 1963-82 time period. This equates to a reduction in the overall inflation rate of approximately 0.25 percentage points per year over this period. Clearly, this is important because of the use of CPI in labor contracts and entitlement payments. Francis J. Cronin, Mark A. Gold and Steven Lewitzky, "Telecommunications Technology, Sectoral Prices, and International Competitiveness, Telecommunications Policy, pp. 553, 559 (September/October 1992).

SWBT analysis indicates that changes in the LEC price cap plan that improve investment incentives can be expected to result in approximately 40 new jobs for each $1 million in additional investment.[15]

Sharpening telecommunications investment incentives in both the federal and state jurisdictions will accelerate progress towards the National Information Infrastructure (NII) goals.[16] Accelerated deployment of advanced telecommunications capabilities will have positive effects on the federal budget by generating additional tax revenues and reducing the administrative cost of some government programs. For example, the A.D. Little Company estimated that a telecommunications infrastructure capable of national support of currently existing telemedicine trials could save over $35B per year in health care costs by increasing the efficiency of the health care infrastructure.[17] Additional economic benefits would flow from the demand multipliers that are activated by the increased levels of telecommunications demand related to the broad array of new services supported by the new infrastructure.

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[15] The impact of job creation can be derived by using employment multipliers published by the U.S. Department of Commerce, Bureau of Economic Analysis (BEA). The BEA employment multiplier represents the total number of jobs created by $1M of demand for the output of a specific industry. For example, the BEA employment multiplier for telecommunications investment is 40. U.S. Department of Commerce, Bureau of Economic Analysis, RIMS II Multipliers, for I-O number 11.0301, Construction: Telephone and Telegraph Facilities. In addition, one study estimates that 47 jobs would be created in Texas per $1M of telecommunications investment. B.L. Weinstein and T.L. Clower, "Social and Economic Benefits of an Advanced Telecommunications Infrastructure in Texas," Center for Economic Development and Research, University of North Texas, April 1993.

[16] Clinton Administration, The National Information Infrastructure: Agenda for Action, September 15, 1993.

[17] A.D. Little Company, Telecommunications: Can It Help Solve America's Health Care Problems?, Cambridge, Mass., July 1992.

Regulatory commissions are increasingly aware of the job creation potential of privately financed telecommunications infrastructure investment. There is a growing recognition that the telecommunications infrastructure can be a strategic tool to position economies for the Information Age, with the added benefit of creating jobs by policy decisions rather than increases in government spending.[18] Thus, the creation of a regulatory structure conducive to infrastructure investment can have a positive impact on the economy, education (both public and private) and health care without increasing the burden on tight budgets of federal, state or municipal governments, rural or urban school districts.

As the comments are filed in this proceeding, a debate between two factions will likely occur. Some are interested in seeing more restrictive regulations on LECs and others will advocate less restrictive regulations. The outcome of this debate will significantly alter the path of the nation's telecommunications infrastructure. Less restrictive regulations will lead to more infrastructure investments and more restrictive regulations will lead to less infrastructure investments.

D. Regulation Must Keep Pace With The Changes In The Marketplace and Technology Which Are Evolving Rapidly.

1. Changes In The Telecommunications Market Justify Both Long-Term And Immediate Changes. (Transition Issues 1A and 1D)

Effective competition provides the greatest economic benefits to customers and has long been recognized as the optimal market structure. In fact, one of the purposes of

[18] This was recognized by the State of Kansas when that state's Governor, on April 14, 1994, signed legislation and a memorandum of agreement that extends an incentive regulation plan for two years. The legislation and agreement call for increased infrastructure expenditures of $64M and 100 new jobs by SWBT in Kansas.

regulation is to replicate competitive market forces, to mold the firm's profit motive into socially optimal outcomes, when market forces cannot be relied upon to achieve these. To foster effective competition, the regulatory structure should be tailored to achieve the greatest benefits possible to consumers and this society as a whole, as the industry transitions to a new competitive environment. This is consistent with the United States Telephone Association (USTA) recommendation that the degree of LEC regulation be tailored to the level of competition in a particular market area.[19] Regulatory oversight would be reduced significantly in markets where competition is present. When competitors enter markets, the Commission's Rules should permit all providers, including price cap LECs, the same degree of pricing flexibility. Markets where competition is present should be removed from price cap regulation. This strategy is also consistent with the Commission's policy of removing AT&T's services subject to competition from price cap regulation and should be extended to the LECs.[20]

Tariff filing and other requirements associated with price cap regulation, such as service categories and banding restrictions, average pricing requirements, as well as the backstop

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[19] The United States Telephone Association Interstate Access Reform Proposal, filed September 17, 1993, contains a framework that should be adopted for such competitive assessment (USTA Petition).

[20] The Commission has long recognized that in effectively competitive markets, market forces can best further the goals of the Communications Act of efficient telecommunications services provided through adequate facilities at reasonable prices. The reason is quite simple: competitive forces best allocate society's resources, encourage innovation and efficiencies, and generally maximize benefits to consumers. Indeed, while limited government regulation of functionally competitive markets may sometimes be appropriate to further important social goals, such as universal service, unduly strict regulation of rates in competitive markets is generally not only superfluous, but harmful to the public interest. Competition in the Interexchange Marketplace, 5 FCC Rcd 2627 (1990) Notice of Proposed Rulemaking, para. 97 (LD Competition).

sharing mechanism, are overly restrictive and impose an undue competitive disadvantage on the LECs facing competition because they preclude the LECs from timely and effective price and service responses to changing market conditions.

In competitive markets, the market will regulate price and explicit price regulation is no longer needed as a substitute for competition or to protect consumers. The market-based price ceiling caused by competitive price responses will limit any firm, including the LECs, from charging an unreasonably high price for any length of time, because customers will simply switch to better value service alternatives. By precluding a major competitor (the LEC) from effective price competition, today's asymmetric regulatory requirements do not function as a safeguard against unreasonable rates; they are a means by which firms may insulate themselves from competitive market pressures, thereby delaying or denying the benefits to consumers that would otherwise arise from a competitive market.[21]

In this proceeding, the Commission should establish rules that allow for increased pricing flexibility when competitors enter markets. Upon a demonstration that markets are competitive, services subject to competition should be removed from price cap regulation and become subject to streamlined regulation because market constraints will replace price caps as the control mechanism to ensure reasonable rates.[22]

Currently, the LECs' most competitive services are subject to the greatest pricing constraints. Prices for high capacity (hicap) services are constrained by the price cap index for

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[21] The Commission recognized these regulatory shortcomings for competitive markets in adopting streamlined regulation for AT&T's competitive services, Id., paras. 98-99.

[22] These services would continue to be regulated Title II communications services, subject to tariff filing requirements and the complaint process.

the trunking basket. In addition, prices are constrained by the hicap upper and lower service band indexes in the hicap service category of the trunking cap basket. Hicap service prices are further restricted by subindexes within the DS1 and DS3 service categories.[23]

These hicap services already face effective competition, particularly in the dense urban areas. Competitors routinely offer customer specific contracts for these services, with prices tailored to the specific package that is sold. Yet, under price caps, the LECs do not have the ability to offer similar customer-specific contracts or to reconfigure service offerings quickly to respond to competition. LECs are precluded from full participation in a competitive market, and customers are precluded from the full range of service options from which they could choose if LECs were free to compete fully. Customers have expressly requested that the LECs be allowed to compete for their business.[24] By allowing the LECs the same pricing flexibility for competitive services as is afforded other competitive providers, this imbalance would be eliminated and the benefits of full and effective competition could be realized.

The competitive assessment of LEC services contained in Appendix COMP shows that some services are now sufficiently competitive in specific geographic market areas. Services such as high capacity services, and geographic market areas where sufficient competitive supply already exists, should be moved outside the existing price cap constraints and

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[23] Each layer of pricing constraints further reduces pricing flexibility.

[24] John Harring and Harry M. Shooshan III, "Free to Compete Meeting Customer Needs in the Provision of the Public Network," (March 1993), Expanded Interconnection with Local Telephone Company Facilities, Ex Parte Presentation of Southwestern Bell Telephone Company, CC Docket No. 91-141, June 11, 1993, (Free to Compete). SWBT's customers expressed their strong desires that SWBT be allowed to compete for their business.

allowed the same regulatory freedoms and pricing flexibility afforded the other communications providers competing in the same markets.

2. LECs No Longer Control "Bottleneck" Facilities. (Transition Issue 1C)

The NPRM's basic question in Transition Issue 1c is essentially moot. It is not appropriate to assume that a LEC controls an "essential facility." The Chief of the Commission's Office of Plans and Policy (OPP) has stated: "there is no bottleneck anymore,"[25] The OPP Chief's conclusion is supported by the application of case law and economic principles to current circumstances.

Recent Commission actions in the special access expanded interconnection proceeding reveal an apparent misunderstanding of essential facilities. In that proceeding, floor space in a LEC central office and interconnection to the LEC's network was considered to be a de facto essential facility required by competitive access providers. Such an interpretation of the essential facilities concept is much too broad, and ignores the economic efficiency goals of regulation.[26] Key points of a more focused and economically appropriate definition of essential facilities are summarized here.

First, as a necessary (but not sufficient) condition, to be designated as a bottleneck, a facility must be an upstream "wholesale" facility that only the LEC can supply, i.e., the LEC must have market power over the wholesale market. If there are alternate

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[25] The Cable-Telco Report, October 11, 1993, p. 16.

[26] See Alexander C. Larson, William E. Kovacic and Douglas R. Mudd, "Competitive Access Issues and Telecommunications Regulatory Policy", 20 J. Contemp. L. (forthcoming 1994).

suppliers of any upstream facility alleged to be "essential," the discussion is moot; the facility cannot be considered a bottleneck.

Second, the upstream facility must be required by the LEC's downstream competitors in providing true competition in the downstream "retail" market, leading to lower total industry costs. If an upstream facility is required by inefficient downstream providers (lured by high regulatory tariff prices) simply to be in business, then the facility is not a bottleneck. Thus, a key consideration in whether to mandate access to an upstream facility is whether it fosters the competitive process, as opposed to benefitting individual competitors.

Finally, facilities should not be designated as essential if a restructure of upstream facility prices under regulatory scrutiny: (1) can result in the same profits for incumbent firms; (2) will not lead to any set of prices exceeding stand-alone cost (for any group of services); and (3) would discourage inefficient investment caused by uninnovative entry.

Thus, the Commission should define an essential facility as a facility whose function currently cannot be reasonably duplicated, that is only available from a single supplier, and that is required by other telecommunications carriers to engage in efficient competition in end-user markets.

II. THE COMMISSION MUST MAKE CHANGES TO LEC PRICE CAP REGULATION IMMEDIATELY.

A. LEC Performance Under Price Cap Regulation Has Benefitted Consumers.

1. LEC Customers Have Benefitted From Price Cap Regulation. (General Issue 2)

LEC customers have benefitted greatly as a result of the LEC price cap plan through lower interstate access rates and continued high service quality. LEC access prices have fallen by over $2B since LEC price cap regulation began. These price reductions reflect the fact that all LECs have kept their rates at or below the applicable price cap indexes. As the Commission states in the NPRM: "Overall, LEC interstate access rates are currently $1.5 billion lower than at the start of price caps, despite overall inflation in the economy of 11.6 percent. Of this total, $373 million is the result of LEC pricing below the cap."[27]

Table 1
LEC Prices Under Price Caps: 1991-93

Interstate Switched Access Prices	**-13%**
U.S. Output Inflation (GNP-PI)	**+12%**
Real Interstate Switched Access Prices	**-25%**

[27] NPRM, para. 25.

Under price cap regulation, the prices of LEC interstate switched access prices have declined by 13 percent,[28] while output prices in the U.S. economy, as measured by gross national product price index (GNP-PI), rose by over 12 percent from 1990 to 1993.[29] As a result, LEC switched access prices have declined well over 25 percent relative to inflation over a short three-year period.

By the end of 1994, the effects of the total price declines by price cap LECs will have accounted for over $5B in reduced customers' bills.

Following are some of the specific consumer benefits of the LEC price cap plan:

a. The Consumer Productivity Dividend (CPD) Has Reduced Rates Overall.

Each year under price cap regulation, prices are reduced by an additional 0.5 percent relative to the productivity that LECs achieved under rate of return (ROR) regulation. Since annual LEC interstate revenue subject to price cap regulation is approximately $20B per year, the CPD will have provided a total of approximately $1B in benefits to consumers over the first four full tariff years under LEC price cap regulation.[30] Because the CPD represents

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[28] In fact, the pace of interstate price declines for price cap LECs has equalled or exceeded the price declines of AT&T and other interexchange carrier services. The magnitude of AT&T price declines to end users since Divestiture has been exceeded by LEC access charge reductions to AT&T.

[29] This calculation uses the GNP-PI currently published (4thQ 1989 value of 110.2; 4thQ 1992 value of 123.4). Using data available at the time each filing was made, the cumulative inflation adjustment from the 1991, 1992, and 1993 Annual Tariff filings was 12.3%.

[30] This amount is determined as 0.5% of $20B for the four years from July 1991 through June 1995 plus an additional 0.5% of $20B for the last three years plus an additional 0.5% of $20B for the last two years plus an additional 0.5% of $20B for the last year of the four year time period.

a permanent price cap index reduction, consumer benefits will be approximately half a billion dollars each year into the future.

b. Pricing Below The Cap Has Provided Benefits.

During 1991, pricing below the cap by the price cap LECS represented about $35M in annual consumer benefits. During 1992, pricing below the cap provided about $144M in additional consumer benefits. During 1993, the price cap LECs priced approximately $386M below price cap limits. Additional pricing below the cap is evident in 1994. Thus, pricing below the cap has provided over $600M in consumer benefits since implementation of the LEC price cap plan.

c. Election Of The 4.3 Percent Productivity Offset Has Provided Benefits.

Over the first three years of the LEC plan (1991-93), some price cap LECs have made voluntary permanent reductions in their price cap indexes by electing the higher 4.3 percent productivity offset. In volunteering to make this permanent reduction in their price cap indexes, these LECs have provided an additional $123M in consumer benefits during the first three years of price cap regulation alone. During 1991, this represented approximately $7M, then more than $39 M in 1992 and $76M in 1993. Since these price cap reductions are permanent, these consumer benefits continue to accumulate. By the end of 1994, consumer benefits from this source will have accumulated to approximately $250M, excluding any further benefits of any LEC that might have elected the higher productivity offset in the 1994 annual filing.

d. Infrastructure Development Has Occurred.

During the first three years under price cap regulation, approximately $60B in investments in property, plant and equipment has been made by the price cap LECs.[31] As of the end of 1992, 43 percent of the price cap LECs' switches were equipped with Signalling System 7 (SS7)-317 and 34 percent were equipped with SS7-394 capabilities. Seventy-six percent of switches were digital stored program control switches. Over 290,000 kilometers of fiber were in place. These infrastructure upgrades have resulted in greater service availability and improved service quality for customers.

e. New Services Have Been Introduced.

By design, the AT&T price cap plan encouraged the introduction of new, repackaged or repriced versions of existing services. The LECs, however, are currently prohibited from the same means of offering new services that have been afforded AT&T and all streamline-regulated carriers. The restrictive regulatory environment under which the price cap LECs must justify each new or slightly modified service offering requested by customers inhibits the introduction of new services. In spite of these restrictions, price cap LECs have offered over 440 new services since January 1, 1994. SWBT has introduced about 50 new services (or groups of services) since the inception of price cap regulation.[32]

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[31] For example, price cap LECs invested approximately $19.2B in gross construction in 1991 and $20.8B in 1992.

[32] Of those services, 10 are ONA-related, another 32 non-ONA new services are effective and approximately 8 have been denied or are pending. SWBT has other new services planned in response to specific customer requests, but several of these are prohibited by the current restrictive rules. Such prohibitions and denials reduce consumer benefits.

The form of regulation that most closely replicates the consumer benefits which are present in an unencumbered, open market system is a pure price cap plan applied only to those services where explicit regulation is appropriate. A pure price cap system creates the financial incentives to deliver services of value to customers in the most effective manner. The current price cap system for the LECs and ROR regulation do not compare favorably to the incentives inherent in a pure price cap plan. The current new service rules significantly increase administrative costs and either severely diminish or eliminate the incentives to offer new services. Regulation can either encourage or choke off the investment necessary for carriers to make available affordable services. Wide-spread network efficiency improvements translate into high-quality, cost-effective telecommunications services to all service areas. Thus, the environment that will facilitate new service availability is more a function of investment in advanced technologies driven by financial opportunities than regulatory mandates. Proper regulatory treatment of new services is also a critical component of any redefinition of the universal service objective, as discussed in the following section.

f. Levels Of Universal Service Have Increased. (Baseline Issues 1B, 8C)

Both the number of households with telephone service and the percentage of households with telephone service have continued to grow since price cap regulation was implemented in 1991. Since then, the number of U.S. households with telephones has risen by 4.6 million,[33] while the number of total U.S. households grew by 4.1 million over the same

[33] The U.S. Bureau of the Census estimates that there were 93.0 million U.S. households with telephones in November of 1993 and 88.4 million in November of 1990. See "Telephone Subscribership in the United States," Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, March 1994, Table 1 (Subscribership Report).